Testimony before the House Banking and Financial Service Committee

May 9, 2012

Thank you, Chairman Knollenberg and members of the Committee. I appreciate having the opportunity to testify before the Committee. My name is John Gerni. I serve as the Regional Vice President for the American Council of Life Insurers, a trade association of life insurance companies that represents approximately 90 % of premiums written for life insurance, annuities, long-term care insurance, and disability income products.

SB 937 is an amendment to a provision within the Michigan Insurance Receivership law that allows for the "netting" of qualified financial contracts. The current Michigan statute is consistent with Section 711 of the National Association of Insurance Commissioners (NAIC)) Insurer Receivership Model Act (IRMA). I make this point because the process for the drafting of model laws at the NAIC is very deliberate...especially for issues involving the rehabilitation of insolvent insurance companies. The NAIC approves model laws with a goal of uniform regulation for not just insurers but more importantly for consumers.

SB 937 would expand upon the provisions and scope of IRMA's Section 711, which is to better enable insurers to enter into qualified financial contracts with financial institutions in order to more effectively manage their asset and liability risks so they can meet their long-term obligations to policyholders and beneficiaries. The point of contention on this bill would allow state or federally chartered financial institutions with security agreements would receive priority status over other creditors and policyholders if an insurer becomes insolvent, even if their agreement do not relate to a netting agreement or qualified financial contract. This proposed priority would reduce the amount of assets in the insolvent insurer's estate which, in turn, would reduce the amount of benefits that are available to policyholders and beneficiaries and/or increase the amount of assessments that are levied by Michigan's Life and Health Guaranty Association on its member companies.

This specific proposal has drawn the attention of insurance regulators involved with insurance company rehabilitation and they have expressed their opposition about this proposal as well as a law that has passed in Indiana. In regards to Indiana, those involved with the drafting of the law, which includes representatives of the life insurance industry as well as insurance regulators, have recognized the problem with the law and intend to correct it in the 2013 legislative session.

We would ask you to remain consistent with the intent of the work of the Receivership regulators and reject this expansion of the insurance receivership law which could have a negative impact to both life insurers who financially support the Life and Health Guaranty Association and consumers/beneficiaries of policies of those companies who may be subject to rehabilitation.

Thank you again for the opportunity to testify.

Indiana Netting Fix

Rahn, Steve [Steve.Rahn@lfg.com]
Sent: Tuesday, May 08, 2012 11:55 AM
To: John Gerni

John --

As you're aware, we've vetted a fix for the Indiana netting statute with ACLI, the Association of Indiana Life Insurance Companies, the IDOI, and other interested parties. The plan is to have this language introduced in the 2013 legislature to conform the Indiana statute with IRMA section 711. That was the intent of the original legislation as presented to the Indiana General Assembly, but as we subsequently learned, the enacted statute was broader than intended as a result of an inadvertent drafting error. The fix is pretty straight forward. It simply requires amending both 27-9-3.1-12(2)(A) and 27-9-3.1-17(2) by adding the words "relating to one or more netting agreements or qualified financial contracts" to be consistent with the corresponding provisions in IRMA section 711. From the conversations I've had, it appears that all the interested parties are comfortable with this approach.

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April 6, 2012

To: Jim Mumford, Chair, Receivership & Insolvency Task Force
Todd Sells, NAIC
David Vacca, NAIC

From: Patrick D. Hughes

RE: Legislative Expansion of IRMA 711

The RITF's IRMA Section 711 Subgroup recently completed a research project regarding the operational and policy implications of IRMA Section 711. IRMA 711 protects contractual provisions in derivative and other financial contacts (referred to as "qualified financial contracts") that honor counterparties' right to terminate; close out and net; and move on collateral in the event of an insurer's insolvency.

Indiana has passed, and Michigan has pending, legislation that would expand the scope of IRMA 711. Indiana law expands the provision to <u>any</u> secured creditors. The Michigan bill expands the provision to any secured interest of financial institutions[1]. <u>Either legislation constitutes an expansion far beyond the model language</u>. The Subgroup's report opposed such legislation, and an ACLI representative has reported to the Chair of the Subgroup that ACLI also is opposed. This memorandum (1) summarizes IRMA 711; (2) describes the legislation that would expand IRMA 711; and (3) identifies the significant policy reasons for opposing that expansion.

I. IRMA 711

IRMA 711, as drafted, applies only to "qualified financial contracts." The section provides that certain counterparty rights, contained in standard qualified financial contracts, will be honored in an insurance receivership despite any statutory or judicial stay. Specifically, those rights are the right to, in summary:

(1) Terminate that contract;
(2) Close out the contract on a net basis;
(3) Move on collateral held pursuant to the QFC; and
(4) Not be subject to voidable preference provisions

[1] Michigan's bill began as applying to any secured creditors, but was amended to apply only to state or federally charged financial institutions that are secured creditors.

II. Expanding Amendments

Pending in Michigan, see Michigan Senate Bill No. 937 (and passed in Indiana, see IC27-9-3.1-12), is a legislative attempt to expand the scope of IRMA 711 to a broader set of secured creditors. Under these amendments secured creditors would, in short, be able to seize collateral without filing a claim with the receiver. The receiver would not have an opportunity to evaluate the claim or verify the secured nature of the claim, and the statutory, court-supervised, process would be avoided. Moreover any posting of collateral could not be reviewed by the receiver and the receivership court to determine if the posting is a voidable preference.

III. Significant Policy Implications

There are significant reasons to oppose this amendment:

(1) The consequences of this provision, unlike IRMA 711 as drafted, have not been reviewed by receivers or through the model process.

(2) IRMA 711 as drafted is substantially modeled on the Bankruptcy Code and Federal Deposit Insurance Act provisions that accomplish the same goal. These federal analogues do not contain the expansive language in the amendment, and therefore this federal consistency rationale does not apply to the expansion. Furthermore, any comfort from the fact that the federal analogues have been employed in numerous insolvencies is not found in an expanded version.

(3) IRMA 711 is based in part on the commercial reality that Qualified Financial Contracts require this termination and netting language for insurance companies to participate in these markets. Moreover, Dodd-Frank derivative provisions are moving derivative markets to uniformity through central clearinghouses. There is no similar suggestion regarding contracts with other secured creditors.

(4) The regulation of derivative use and accounting involves limits on the purpose and quantity of such exposure, helping to satisfy certain receivership concerns.

(5) Insurance companies do not have such expanded rights when the insurance company is a secured creditor of a bankrupt non-insurance entity. Therefore, the expanded provisions create asymmetric advantages – substantially disadvantaging insurance companies in relation to non-insurance entities.

(6) These amendments undermine consistency. IRMA 711 in substantially similar form has been adopted in New York, Illinois, Connecticut, Texas, and many other states. This emerging uniformity on an issue of national importance is now in danger of turning into a regulatory patchwork with vastly different mechanisms for resolving secured claims throughout the country.